**There are three basic types of business enterprises --**

**Service, Manufacturing, and Merchandising.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | Service |  | Companies | http://olc.spsd.sk.ca/de/acct20/images/clipart/rightarrow.gif |  |
|  |  |  |  |  |  | http://olc.spsd.sk.ca/de/acct20/images/clipart/downarrow.gif |
|  |  | Merchandising |  | Companies |  |  |
|  |  |  |  |  |  | http://olc.spsd.sk.ca/de/acct20/images/clipart/downarrow.gif |
| Manufacturing | http://olc.spsd.sk.ca/de/acct20/images/clipart/rightarrow.gif | Wholesaler | http://olc.spsd.sk.ca/de/acct20/images/clipart/rightarrow.gif | Retailer | http://olc.spsd.sk.ca/de/acct20/images/clipart/sidedownarrow.gif | . |
| Companies |  |  |  |  |  | Customers |
|  |  | http://olc.spsd.sk.ca/de/acct20/images/clipart/rightarrow.gif |  | Retailer | http://olc.spsd.sk.ca/de/acct20/images/clipart/sideuparrow.gif | . |

**http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gifService Enterprises** - do not sell products; provide a service to the public for a fee.   
**http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gifManufacturing Enterprises** - convert raw materials into salable products. Usually, a manufacturer sells its products to merchandising companies such as wholesalers and retailers.  
**http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gifMerchandising Enterprises** - buy goods and then sell those goods to customers for profit. Both wholesalers and retailers are included in this group. Some merchandising businesses are both retailers and wholesalers. A retailer is an enterprise that sells to the final user -- the consumer. A wholesaler is an enterprise that sells to retailers.

How to identify a Merchandising Enterprise

* buys goods for resale
* marks up goods for resale
* sells goods to consumers
* may have both a **primary** and a **secondary** source of revenue \* Eg - a garage's primary source of revenue may be to service vehicles (service aspect) and the secondary source may be the selling of parts (merchandising aspect).

**Merchandising Roles**  
In the Canadian business environment, there exists an interdependence among the various types of business enterprises. Producers, manufacturers, wholesalers, retailers, and consumers all have roles in merchandising.

http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gif**Producer** - supplies raw materials  
http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gif**Manufacturer** - makes a product  
http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gif**Wholesaler** - buys in large quantities and sells to retailer  
http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gif**Retailer** - sells to consumers  
http://olc.spsd.sk.ca/de/acct20/images/buttons/pebble.gif**Consumer** - the one buying the good(s)

**NOTE:** A business such as a dairy that buys milk from the producer/farmer, is the consumer, becomes the manufacturer of certain products, acts as a wholesaler, and may act as a retailer in door-to-door sales.

**What are acquisition price, selling price, and how do they relate to cost?**  
A merchandising company must buy and pay for the merchandise it sells. The expenses of operating the business must also be paid for. Therefore, the difference between **cost price** and **selling price** must cover certain costs in order to make a profit.

The method used to determine a selling price will vary depending upon the demand for the product, the competition, as well as the cost of the good or service being sold. The difference between cost price and selling price may include:

* **profit**
* **overhead**
* **storage**
* **advertising**
* **selling**
* **delivery**
* **salaries**

Each firm has its own method to arrive at a selling price. The importance is to realize how the different elements are dependent upon one another. The following is one example.

|  |  |  |  |
| --- | --- | --- | --- |
| **Element** | **Dollar Amount** | **Percent Desired** | **Calculation for Dollar Amount** |
| **Selling Price** | **28.00** | **N/A** | **20.00 + 2.00 + 6.00** |
| **Desired Profit** | **6.00** | **(30%)** | **20.00 x 30%** |
| **Overhead** | **2.00** | **(10%)** | **20.00 x 10%** |
| **Cost Price** | **20.00** | **(100%)** | **N/A** |

1. A farmer who supplies wheat to a mill would be:

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[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)producer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)manufacturer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)retailer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)consumer

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2. The business that buys flour from the mill would be a:

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[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)retailer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)producer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)consumer

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3. The business that makes the bread to sell to the wholesaler is a:

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[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)producer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)consumer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)retailer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)manufacturer

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4. The business that sells the bread to the final consumer is a:

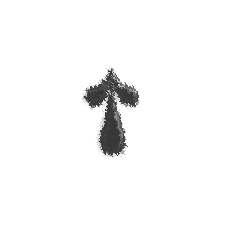
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[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)producer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)wholesaler  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)retailer  
[http://olc.spsd.sk.ca/de/acct20/images/buttons/lightedmini.gif](http://olc.spsd.sk.ca/de/acct20/module2a/selfcheck2a2.html)manufacturer

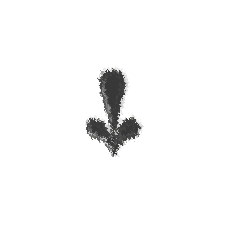
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**What is Markup, Margin, and Markdown?**Although various factors have a role in the pricing decision, the emphasis is often on cost and profit. The price a business establishes for a good or service it sells must reflect:

* the cost of the good or service
* the operating costs of the business - these may include wages, overhead, and other things necessary to carry on the business
* the profit necessary to make it worthwhile to stay in business

When retailers buy goods from wholesalers or manufacturers, the amount added to the cost price is called **markup**. Markup is most often expressed as a percentage of cost price. 

When the amount added to the cost price is expressed as a percent of retail, it is called **margin**. http://olc.spsd.sk.ca/de/acct20/images/clipart/raperc.gif

Overstocked, out of season, and expired goods may be reduced in price or placed on sale. This is called **markdown** and is based on retail price. 

**Markup**

* the difference between the selling price of the good and the cost of the good
* can be based on either the cost of the good or the selling price

Despite the method used, when pricing goods one must consider the cost of the good, the business overhead and the profit desired. Simply stated:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Selling Price** | **=** | **Cost of Goods** | **+** | **Overhead** | **+** | **Profit** |
| **SP** | **=** | **C** | **+** | **O** | **+** | **P** |

Overhead and profit are components used to determine markup, therefore:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Selling Price** | **=** | **Cost of Goods** | **+** | **Markup** |
| **SP** | **=** | **C** | **+** | **M** |

NOTE: It is common to see the terms margin or gross profit used instead of markup.

Example: A computer costs $1250. If the overhead costs per computer sold are $125 and the desired profit is $200, find:

a) the selling price

b) the markup

a) To find the selling price:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **C=1250** |  | **O=125** |  | **P=200** |
| **SP** | **=** | **C** | **+** | **O** | **+** | **P** |
| **SP** | **=** | **1250** | **+** | **125** | **+** | **200** |
| **SP** | **=** | **1575** |  |  |  |  |

b) To find markup:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **MU** | **=** | **O** | **+** | **P** |
| **MU** | **=** | **125** | **+** | **200** |
| **MU** | **=** | **325** |  |  |

**Markdown**

* the dollar amount by which the normal price has been reduced

Example: An art store advertises prints selling for $500. A special offer is being made and the prints have been marked down to $425. What is (a) the dollar amount and (b)the percent of markdown?

**(a) Dollar amount of Markdown =**

500 - 425 = 75

**(b) Percent of Markdown (PMU) =**

**Dollar Amount of Markdown ($MD)  
Normal Selling Price (SP)**

75  
500  
= 15%

Use the following terms to fill in the blanks:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Selling Price | Percent Markdown | Markup | Margin | Markdown |

1. Overhead plus profit is: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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2. The amount added to cost and expressed as a percent of retail is:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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3. The cost of good plus the overhead plus the profit is:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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4. The dollar amount of markdown divided by the normal selling price is:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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5. The dollar amount of a price reduction is:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**What are Merchandising Accounts?**Recall the different forms of business ownership:  
 **Sole Proprietorship** - owned and operated by one person. The owner is responsible for all operations of the business and assumes all the risk.

**Partnership** - two or more people jointly share in the ownership and operation of the business.

**Corporation** - is a legal entity that exists independently of its owners (the shareholders). Corporations are complex and can be classified as private, public, Crown or non-profit.

**Franchise** - a person who buys a franchise acquires a license to manufacture or sell a product or service of an established business.

**This course will be based upon a merchandising business organized as a partnership.**

**More on Partnerships**

Partnerships are similar to sole proprietorships but are a bit more complex to organize. Since more than one person is involved in the business, the partnership must be created by either a verbal or written agreement. It is in the best interest of the partners to draft a written agreement, called the **articles of partnership**, or **partnership agreement**. If there are any disputes in the future, the terms of the partnership agreement will be upheld in court. Whenever two or more people form a business, they should consider the issues of financing, ability of the partners to contribute equally, decision making, management, profit sharing, and termination of the relationship. A partnership agreement must be signed by all the partners and will usually include the following information:

* name and location of the business
* purpose of the business
* names of the partners
* amount of the partner's investment
* how the profits and losses are to be divided
* duties and responsibilities of each partner
* procedures for handling a partner's share of the partnership upon termination, retirement, or death
* procedures for dissolving the partnership

|  |  |
| --- | --- |
| **Advantages** | **Disadvantages** |
| * inexpensive and easy to organize * all partners provide capital to start the business * partners can combine personal assets as collateral if additional financing is needed * partners can bring more expertise into a business because each one will have different areas of knowledge * partners can provide better management thereby reducing the risk of business failure * the partners share the debt according to the partnership agreement if the business is not doing well | * unlimited liability for the debts of the business * even if two partners are sharing profits 60-40, each is 100 percent liable for any debts of the business * each partner's personal assets can be used to pay off the debts if necessary * if one of the partners has few or no assets, the other partner(s) will have to assume responsibility for the debts * the partners share profits according to the terms of the partnership agreement regardless of the contribution they make personally or otherwise * difficulty in resolving differences |

The primary differences between a merchandising firm and a service firm are that a merchandising business purchases merchandise for resale, charges sales tax on sales of merchandise, and includes a Cost of Merchandise Sold section on the Income Statement.

In order to perform the transactions required by a merchandising firm, several new accounts must be introduced and the numbering of accounts is adjusted accordingly.

**(1) Assets**  
Merchandise Inventory  
 **(2) Liabilities**  
Sales Tax Payable  
Payroll Accounts

**(3) Owner's Equity**  
Capital and drawing accounts for each partner

**(4) Operating Revenue**  
Sales and related accounts

**(5) Cost of Merchandise**  
Purchases and related accounts  
**(6) Expenses**  
Payroll Expenses

**What is Merchandise Inventory?**

Goods bought for resale are called **merchandise**. The items of merchandise on hand are referred to as **inventory**. The inventory is represented in the general ledger by the asset account **Merchandise Inventory**. Merchandise Inventory is the only account reported on both the Balance Sheet (as a current asset) and on the Income Statement (to calculate the cost of merchandise sold). Merchandise Inventory is one of the largest asset accounts. By keeping track of merchandise, a business knows:

* how much merchandise is sold
* which items are selling well
* which items, when sold, should not be replaced.

Beginning inventory is the merchandise a business has on hand and available for sale at the beginning of a period. Ending inventory is the merchandise a business has on hand at the end of a period. The ending inventory (items not sold) for one period becomes the beginning inventory for the next period.

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| End Period 1 | http://olc.spsd.sk.ca/de/acct20/images/arrows/blcurrarwtran.gif | Count End Inventory | http://olc.spsd.sk.ca/de/acct20/images/arrows/blcurrarwtran.gif | Beginning Period 2 | http://olc.spsd.sk.ca/de/acct20/images/arrows/blcurrarwtran.gif | Sales | http://olc.spsd.sk.ca/de/acct20/images/arrows/blcurrarwtran.gif | End Period 2 | http://olc.spsd.sk.ca/de/acct20/images/arrows/blcurrarwtran.gif | Count End Inventory | http://olc.spsd.sk.ca/de/acct20/images/arrows/blcurrarwtran.gif | Beginning Period 3 |

Two main methods used to determine merchandise inventory are:  
 1.**Periodic** - merchandise inventory is determined by counting, weighing, or   
 measuring items on hand - also known as **physical inventory**.   
 2. **Perpetual** - merchandise inventory is determined by keeping a continuous record   
 of increases, decreases, and balance on hand - also known as **book inventory**.

|  |  |
| --- | --- |
| Perpetual | Periodic |
| * keeps a constant, up-to-date record of merchandise on hand * reports merchandise on hand at any time * every time a purchase or sale occurs, an entry is recorded in the Merchandise Inventory account * purchase account is not used * used by most large businesses as well as smaller ones with automated accounting systems   Note: a physical inventory must still be taken at the end of the period to identify | * inventory records are updated only after a physical count of merchandise on hand is made * inventory records are not adjusted for every purchase or sale * physical count is done to update accounting records * purchase account is used * used by small businesses that maintain manual records   theft, spoilage, losses, etc. |

**Complete the following based on the Merchandise Inventory information.**

1. An inventory system in which a constant record of merchandise on hand is maintained is called \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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2. An inventory system in which records are updated only after a physical count of merchandise on hand is made is called \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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3. An inventory system most likely used by a large business is called \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_Top of Form

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4. Merchandise Inventory is an asset account that appears on both the Income Statement and the Balance Sheet.

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True  
False

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5. The ending inventory for one period becomes the beginning inventory for the next period.

Top of Form

True  
False

**What is a Cost of Goods Sold?**

Merchandising firms must purchase the goods they sell, then price them to cover costs and earn a profit. Buying inventory for resale adds a section to the income statement called **Cost of Goods Sold**. This separate category of information is related to the cost of making goods available to customers. The Cost of Goods Sold section is the only difference between the income statement for a service firm and that of a merchandising firm.

**Recall:** At the beginning of a new period there is inventory on hand. Merchandise is sold throughout the period and is replaced with the purchase of new stock. The inventory at the end of the period is the amount unsold. It is therefore necessary to know the cost of purchasing and selling the merchandise for the period in order to calculate profit for the period (**Gross Profit or Gross Margin**). Gross Profit is the difference between Revenue and Cost of Goods Sold.

**Calculating Cost of Goods Sold**

|  |  |
| --- | --- |
| Beginning merchandise inventory, January1, 20-- (Debit balance of Merchandise Inventory in the  Trial Balance Debit column of the work sheet). . . . . . . | 170,500.00 |
| Plus purchases made during the fiscal period (Debit balance of Purchases in the Income Statement Debit column of the work sheet). . . . . . . . . | +60,500.00 |
| Equals total cost of merchandise available for sale during the period. . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 231,000.00 |
| Less ending merchandise inventory, December 31, 20-- (Debit balance of Merchandise Inventory in the  Balance Sheet Debit column of the work sheet). . . . . . . . | -31,000.00 |
| Equals cost of merchandise sold during the fiscal period. . | 200,000.00 |

**NOTE:**  
**Theft or loss of inventory is automatically calculated in Cost of Goods Sold  
Why - Because physical inventory was done.**

**Cash and Trade Discounts**

The total amount shown on an invoice is not always the amount that the purchaser will pay. Discounts often affect the amount to be paid. The terms of sale determine how much and when the discounts can be given. Two types of discounts are a cash discount and a trade discount.

**Cash Discount** - a deduction that a seller allows on the amount of an invoice to encourage prompt payment. This is usually stated as a percentage that may be deducted from the total.

**Example:** Terms of sale may be written as 2/10, n/30

This is read as two ten, net thirty

What does it mean?  
2/10 means 2% of the invoice amount may be deducted if paid within 10 days from the invoice date.

Merchandise Purchased x Discount Rate = Discount  
$2000 x .02 = $40

Invoice Amount - Discount Amount = Amount Paid Within Discount Period  
$2000 - $40 = $1960

A couple of other terms to be familiar with are:

**n/30 -** Net Thirty- means that the total amount of the invoice must be paid within 30 days.

**C.O.D.** - Cash on Delivery - full payment is made in cash upon delivery of the goods.

**E.O.M.** - End of Month - full payment is expected not later than the end of the month.

**On Account or Charge** - payment will be made at a later date set by the terms of sale.

**Interesting to Note:**  
To the seller of the goods a cash discount is a sales discount.  
To the purchaser of the goods a cash discount is a purchases discount.

There are times when different prices may be offered to different customers such as hospitals or educational institutions. It would be impractical to have different price lists to suit the needs of all buyers. Therefore, a trade discount is offered.   
**List Price** - the printed or catalogue price  
**Trade Discount** - a reduction from the list price

When a trade discount is granted, the net amount after the discount has been deducted from the list price is the actual amount owing on the invoice. Only the net amount of the invoice is used for the journal entry and is recorded by the seller and the buyer as the same amount. There is no entry required for the trade discount.

List Price x Trade Discount Rate = Trade Discount Amount  
$60 x 30% = $18

List Price - Trade Discount Amount = Net/Invoice Amount  
$60 - $18 = $42

**Self Check**

1. Cash Discount is a deduction that a vendor allows on the invoice amount to encourage prompt payment.

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True  
False

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2. A reduction in the list price granted to customers is a trade discount.

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True  
False

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3. Trade discounts are recorded in the purchases discount account.

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True  
False

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4. The terms of sale 1/10, n/30 mean that the customer may deduct 1% of the invoice amount if payment is made within 30 days of the invoice date.

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True  
False

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5. The terms of sale 2/15, n/30 mean that 2% of the invoice amount may be deducted if paid within 15 days of the invoice date or the total invoice amount must be paid within 30 days.

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True  
False

**What are Sales?**When a merchandising business sells goods to a customer, the amount of the merchandise sold is recorded in the Sales account. **Sales** is a revenue account that has a credit as a normal account balance. Therefore, increases to the Sales account are recorded as credits, and decreases are recorded as debits.

|  |
| --- |
| **Sales** |

|  |  |
| --- | --- |
| Debit | Credit |
| Decrease | Increase  Normal Balance |

Customers are not always satisfied with merchandise they purchase. When customers return merchandise, the seller must issue a credit memorandum or return cash that was paid. A full return of the purchase price is a sales return. If the customer decides to keep the merchandise and receive a partial credit, a sales allowance is given.

A sales return or allowance decreases the Sales account. However, businesses often record these amounts in a separate account to better track the lost sales. The Sales account shows the gross sales for the accounting period. The **Sales Returns and Allowances** account is a contra account. Its balance decreases the balance of the Sales account. The normal balance of Sales Returns and Allowances is a debit.

|  |
| --- |
| **Sales Returns and Allowances** |

|  |  |
| --- | --- |
| Debit | Credit |
| Increase  Normal Balance | Decrease |

Recall that a cash discount may be offered as incentive for prompt payment. This cash discount is called a Sales Discount. The **Sales Discount** account is another contra account to Sales and has a normal account balance of a debit.

|  |
| --- |
| **Sales Discount** |

|  |  |
| --- | --- |
| Debit | Credit |
| Increase  Normal Balance | Decrease |

**Partial Income Statement - Demonstrating Contra Sales Accounts**

|  |  |  |
| --- | --- | --- |
| Revenue |  |  |
| Sales |  | 51,000 |
| Less:  Sales Returns and Allowances Sales Discount | 550 450 | 1,000 |
| Net Sales |  | 50,000 |
|  |  |  |

**Applied GAAP** **Realization of Revenue Principle** - revenue should be recognized at the time it is earned and adjustments made for all discounts.

Both sales for cash and on account are recorded as credits to the Sales account. Sales on account will affect the Accounts Receivable account. Cash sales will affect the Cash account.

Sold $50 of merchandise on account:  
Sales

|  |  |
| --- | --- |
| Debit | Credit |
|  | 50 |

|  |
| --- |
| Accounts Receivable |

|  |  |
| --- | --- |
| Debit | Credit |
| 50 |  |

\*\*Source document - sales invoice

Sold $40 of merchandise for cash:  
Sales

|  |  |
| --- | --- |
| Debit | Credit |
|  | 40 |

|  |
| --- |
| Cash |

|  |  |
| --- | --- |
| Debit | Credit |
| 40 |  |

\*\*Source document - sales slip/invoice

Returned merchandise is recorded as a debit to Sales Returns and Allowances. If the customer had paid cash, the cash is returned (credit). If the customer had charged the merchandise on account (Accounts Receivable) their account is reduced (credit) provided they have not paid their account.

Customer returns $35 of merchandise for a cash refund:

|  |
| --- |
| Sales Returns and Allowances |

|  |  |
| --- | --- |
| Debit | Credit |
| 35 |  |

|  |
| --- |
| Cash |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 35 |

\*\*Source document - credit memorandum

Customer returns $20 of merchandise previously bought on account and not paid for yet:

|  |
| --- |
| Sales Returns and Allowances |

|  |  |
| --- | --- |
| Debit | Credit |
| 20 |  |

|  |
| --- |
| Accounts Receivable |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 20 |

\*\*Source document - credit memorandum

Sales discounts are offered to charge customers to encourage prompt payment. When payment is received, it is less the discount.

Customer pays $1960 on account within the discount period.   
The original invoice was $2000 - terms 2/10, n/30:

|  |
| --- |
| Cash |

|  |  |
| --- | --- |
| Debit | Credit |
| 1960 |  |

|  |
| --- |
| Accounts Receivable |

|  |  |
| --- | --- |
| Debit | Credit |
| Balance - 2000 | 2000 |

|  |
| --- |
| Sales Discount |

|  |  |
| --- | --- |
| Debit | Credit |
| 40 |  |

\*\*Source document - credit memorandum to credit the accounts receivable account

**Applied GAAP:** **Objectivity Principle** - all transactions must be supported by objective evidence (source documents).

**Fill in the blanks using the following words**

**Sales Sales Discount Sales Return Sales Allowance Sales Returns & Allowances**

1. Normal account balance is a credit because this account increases capital. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_Top of Form

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2. This account is used when customers return goods for various reasons. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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3. This account is used when customers reduce payment according to terms of sale.Top of Form\_\_\_\_\_\_\_\_\_\_\_\_\_  
Bottom of FormTop of FormBottom of Form

4. Credit allowed a customer for part of the sales price of merchandise that is not returned, resulting in a decrease in the vendor's accounts receivable.\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Top of Form

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5. Credit allowed a customer for the full sales price of returned merchandise, resulting in a decrease in the vendor's accounts receivable.\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**What are Purchases?**Top of Form

The cost of goods purchased for resale is one of the major costs of operating a merchandising business. The **Purchases** account is used to record this cost. The Purchases account is debited because costs decrease the net income and ultimately decrease owner's equity.

Purchases

|  |  |
| --- | --- |
| Debit | Credit |
| Increase  Normal Balance | Decrease |

The cost of transporting the merchandise to the retailer's business increases the cost of merchandise for resale. The account set up to record shipping charges is **Transportation In** or **Freight In**.

|  |
| --- |
| Transportation In |

|  |  |
| --- | --- |
| Debit | Credit |
| Increase  Normal Balance | Decrease |

Shipping terms are stated as FOB destination or FOB shipping point. "**FOB**" means "free on board". **FOB destination** means that the supplier pays the shipping cost to the purchaser's location. **FOB shipping point** means that the purchaser pays the shipping charge from the supplier's shipping point.

There are times when the merchandise purchased is unsuitable for resale and is returned. When the purchaser returns merchandise, a cash refund is given for items previously paid for, and a credit is given for unpaid invoiced items. An allowance may be given if the purchaser decides to keep the merchandise at a decreased purchasing price. **Purchases Returns and Allowances** is a contra account to Purchases and is used to record merchandise returned to the supplier (or allowances allowed for unsuitable merchandise kept).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| |  |  | | --- | --- | | Debit | Credit | | Decrease | Increase  Normal Balance |   Purchases Returns and Allowances |

A discount may be offered by the supplier to promote prompt payment from the purchaser. **Purchases Discounts** is the account set up to record this cash discount. Purchases Discounts is a contra account that reduces Purchases and therefore has a credit as a normal account balance.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| |  |  | | --- | --- | | Debit | Credit | | Decrease | Increase  Normal Balance |   Purchases Discounts |

**Partial Income Statement - Demonstrating Purchases and Related Accounts**

|  |  |  |  |
| --- | --- | --- | --- |
| Cost of Goods Sold |  |  |  |
| Merchandise Inventory, May 1 |  |  | 8,000 |
| Add: Purchases |  | 20,000 |  |
| Less: Purchases Returns and Allowances Purchases Discounts | 3,000 500 | 3,500 |  |
| Net Purchases |  | 16,500 |  |
| Add: Transportation In |  | 1,500 |  |
| Cost of Merchandise Purchased |  |  | 18,000 |
| Cost of Merchandise Available for Sale |  |  | 26,000 |
| Less: Merchandise Inventory May 31 |  |  | 16,000 |
| Cost of Goods Sold |  |  | 10,000 |

**Applied GAAPs**:  
**Cost Principle** - the cash or market value of the good is the amount recorded.   
**Matching Principle** - appropriate costs are matched against like revenues for a specific period.Bottom of Form

Both purchases for cash and on account are recorded as debits to the Purchases account. Purchases on account will affect the Accounts Payable account. Cash purchases will affect the Cash account.

|  |  |
| --- | --- |
| Debit | Credit |
| 60 |  |

Purchased $60 of merchandise on account:  
Purchases

|  |
| --- |
|  |

|  |
| --- |
| Accounts Payable |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 60 |

\*\*Source document - purchase invoice

|  |  |
| --- | --- |
| Debit | Credit |
| 85 |  |

Purchased $85 of merchandise for cash:  
  
Purchases

|  |
| --- |
|  |

|  |
| --- |
| Case |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 85 |

\*\*Source document - purchase invoice

Transportation costs may be invoiced separately or paid for with cash.

Received invoice from GoExpress - $45 freight on merchandise purchased:

|  |
| --- |
| Transportation In |

|  |  |
| --- | --- |
| Debit | Credit |
| 45 |  |

|  |
| --- |
| Accounts Receivable/GoExpress |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 45 |

Paid $35 cash for freight on delivery of merchandise purchased:

|  |
| --- |
| Transportation In |

|  |  |
| --- | --- |
| Debit | Credit |
| 35 |  |

|  |
| --- |
| Cash |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 35 |

\*\*Source document - debit memo or freight invoice

Returned purchases are recorded as a credit to Purchases Returns and Allowances. If cash had been paid, cash is received for returned merchandise. If the invoice is not paid for yet, the Accounts Payable account is reduced.

Purchaser returns $25 of merchandise for cash refund:

|  |
| --- |
| Purchases Returns and Allowances |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 25 |

|  |
| --- |
| Cash |

|  |  |
| --- | --- |
| Debit | Credit |
| 25 |  |

\*\*Source document - credit memorandum

Purchaser returns $15 of merchandise previously bought on account but not paid for yet:

|  |
| --- |
| Purchases Returns and Allowances |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 15 |

|  |
| --- |
| Accounts Payable |

|  |  |
| --- | --- |
| Debit | Credit |
| 15 |  |

\*\*Source document - credit invoice

Purchases discounts are offered to encourage prompt payment. When payment is made, it is less the discount.

Payment of $784 is made. Discount of $16 is taken on original invoice of $800 - terms 2/10, n/30.  
Cash

|  |  |
| --- | --- |
| Debit | Credit |
|  | 784 |

|  |
| --- |
| Accounts Payable |

|  |  |
| --- | --- |
| Debit | Credit |
| 800 | Balance 800 |

|  |
| --- |
| Purchases Discounts |

|  |  |
| --- | --- |
| Debit | Credit |
|  | 16 |

\*\*Source document - purchase invoice with terms and cheque for payment

**Use the following terms to fill in the blanks below:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Purchases | Purchases Discount | Purchases Returns | Purchases Allowances | Purchases Returns and Allowances |

1. An amount allowed to a purchaser for the full purchase price of returned merchandise, resulting in a decrease in the purchaser's accounts payable. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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2. An amount allowed to a purchaser for part of the purchase price of merchandise that is kept at a reduced price. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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3. This account is used when merchandise is returned to the supplier for various reasons.   
\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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4. Normal account balance is a debit because these costs decrease capital. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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5. This account is used when payment is reduced according to terms of purchase. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_Top of Form

Bottom of Form

Bottom of Form

**Source**

<http://olc.spsd.sk.ca/de/acct20/module2a/tablemodule2a.html>

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